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No. 80-228

In the Supreme Court of the United States

OCTOBER TERM, 1979

SUBURBAN REALTY COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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In this federal income tax case, petitioner seeks review of the decision below holding that six parcels of real estate sold by it were held "primarily for sale to customers in the ordinary course of * * * [its] trade or business" within the meaning of Section 1221(1) of the Internal Revenue Code of 1954 (26 U.S.C.), so that the profits realized on the sales were taxable as ordinary income rather than as capital gain.

The pertinent facts may be summarized as follows: Petitioner was formed in November 1937 to acquire an undivided one-fourth interest[1] in 1,742.6 acres of land located in Harris County, Texas. Petitioner received its

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[1]The remaining three-fourths undivided interest in the property was held by Mary Alice Talbot and George Hamman.

interest in the property from four individuals in exchange for all of its stock. (Pet. App. 2a). Petitioner's charter stated that it was formed to erect or repair any building or improvement, and to accumulate and lend money for such purposes, and to purchase, sell, and subdivide real property, and to accumulate and lend money for that purpose (Pet. App. 2a, 3a).

Certain portions of the property were designated as Homestead Additions One, Two, Three, and Four.[2] Except for the connecting of a few utility lines, Homestead Addition One was undeveloped. Homestead Addition Two, however, which was acquired in its entirety by petitioner in 1948, was platted and streets and sewers were installed. Petitioner also built a lumber yard on this section, as well as 11 houses which were sold by 1958. From 1948 to 1966, petitioner, as sole owner, sold 252 subdivided lots from Section Two, many of them in bulk sales (Pet. App. 6a, 7a).

In 1938, petitioner and the other owners of the property formed Houston Gardens, Annex, Inc., a separate corporation, in order to plat and sell a parcel located in the northeast quadrant of the property. Each owner received stock in the new corporation in proportion to its interest in the property. Prior to its liquidation in 1961, Houston Gardens sold a total of 200-250 lots located within the parcel (Pet. App. 6a).

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[2]Homestead Additions Three and Four were platted for residential use in 1951 (Pet. App. 7a). In 1957, the Texas Highway Department proposed a superhighway whose route would cross petitioner's property (Pet. App. 4a, 5a). As a result of this announcement, land values near the highway nearly tripled (Pet. App. 5a). In order to maximize its profits, petitioner withdrew its residential plat in 1961, thereby permitting sales of parcels in this area of the property for commercial and industrial uses (Pet. App. 36a, 37a). The remainder of the acreage owned by petitioner and its co-owners was not developed; however, during the period 1939-1971, sales were made from this remaining acreage (Pet. App. 7a).

During 1939-1971, petitioner, as sole owner of Homestead Addition Two and as co-owner of the remainder of the property, made at least 244 separate sales of realty from the property, of which approximately 95 were of unplatted and unimproved land suitable for commercial or other development, and at least 149 were of platted property limited to residential development (Pet. App. 4a, 31a-32a). Petitioner's total receipts from these sales were $2,353,935 (Pet. App. 4a).

The transactions in dispute here involve six tracts of unimproved real estate sold in five transactions between 1968 and 1971. In accordance with its uniform past practice, petitioner indicated on its tax returns for these years that it was in the business of "real estate" or "real estate development and sales". Consistent with that designation, it reported all its income, including the income from the sales in question, as ordinary income (Pet. App. 3a, 37a). Petitioner subsequently filed a claim for refund asserting that the six tracts, as well as three other tracts sold later, were capital assets qualifying for capital gain treatment. The Internal Revenue Service denied petitioner's claim as to the six tracts[3] and petitioner then instituted this refund suit in the United States District Court for the Southern District of Texas (Pet. App. 3a).

The district court upheld the Internal Revenue Service's determination that petitioner's profits from the land sales were taxable as ordinary income. It held that petitioner's primary purpose in acquiring and holding the properties at issue was to sell them to customers in the ordinary course of its real estate business so that the properties did

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[3]Petitioner's claim with respect to the three other tracts was allowed, and $70,377.79 was refunded.

not qualify as capital assets under Section 1221(1) of the Code (Pet. App. 33a-40a). The court of appeals affirmed (Pet. App. 1a-32a).

1. The decision below correctly held that petitioner's gain from the sale of the six tracts was taxable at ordinary income rates. The case turns on its particular facts and presents no legal question worthy of review by this Court.

Section 1221 of the 1954 Code generally defines the term "capital asset" as "property held by the taxpayer". However, the statute excludes from the definition of capital asset "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business". Section 1221(1). This limitation precludes the capital gain treatment sought by petitioner.

As the court of appeals pointed out, petitioner was in the business of selling real estate and the parcels in question were held by it primarily for sale in the ordinary course of such business. The record fully supports, indeed compels, this conclusion. Petitioner's long history of continuous and frequent sales of its real property—sales which accounted for most of petitioner's income—refutes its contention in this litigation that it was not in the business of selling real estate. These sales, moreover, fully accord with petitioner's statements on its tax returns that its principal business activity was "real estate" or "real estate development and sales" (Pet. App. 37a).

2. Contrary to petitioner's contention (Pet. 8-13), the court of appeals properly considered the overall history of its sales activities in reaching the conclusion that the six parcels of land in question were held by petitioner "primarily for sale" in the ordinary course of its real estate business. Although not conclusive, a history of holding other property for sale in the normal course of its real

estate business is highly probative evidence of the taxpayer's intent, or holding purpose, with respect to similarly situated property. *Biedenharn Realty Co.* v. *United States*, 526 F. 2d 409, 416 (5th Cir.), cert. denied, 429 U.S. 819 (1976). The taxpayer, to be sure, may overcome the inferences arising from its history of sales by establishing that a shift in its holding purpose (from sale in the ordinary course of business to investment) occurred prior to the sales in question, or that the sales were independent of its ongoing real estate business. See, *e.g.*, *Municipal Bond Corporation* v. *Commissioner*, 382 F. 2d 184 (8th Cir. 1967); *Scheuber* v. *Commissioner*, 371 F. 2d 996 (7th Cir. 1967).

Here, however, petitioner failed to show that it had terminated its real estate business prior to the sales of the six parcels in question or that such sales were independent of its continuing business. The court of appeals (Pet. App. 25a-27a) carefully examined petitioner's claim that a shift in its holding purpose occurred before the transactions in dispute but found the evidence cited by petitioner in support of this purported shift in purpose unconvincing.[4] The court thereupon considered (Pet. App. 27a-28a) whether petitioner's purpose in holding the specific parcels at issue was different from its purpose for holding the property as a whole. The court concluded that petitioner had not met its burden of establishing a different purpose for the six parcels, pointing out that the

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[4]In support of its position, petitioner pointed to such facts as the initiation of liquidation discussions, the advent of Rice University as a stockholder, and the withdrawal of the residential plats which had previously been filed with respect to certain tracts. The court noted that while the withdrawal of residential plats may evidence a shift in holding purpose, the record before it indicated that the withdrawal of the residential plats here was aimed at maximizing petitioner's profits by selling the parcels to commercial users (Pet. App. 26a-27a).

mere lack of development activity with respect to the six parcels did not demonstrate an investment purpose and was not inconsistent with a primary motivation to maximize immediate sales profits.

It is therefore apparent that the court of appeals did not treat petitioner's sales activities with respect to other parcels of the property as determinative of its primary purpose in holding the specific parcels at issue. Rather, the court was unconvinced on the record before it that the sales transactions in dispute were of a different character than petitioner's previous sales. This case therefore turns on its particular facts and does not conflict with the decisions of other courts.[5]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

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[5] *Commissioner* v. *Tri-S Corporation*, 400 F. 2d 862 (10th Cir. 1968) and *Municipal Bond Corporation* v. *Commissioner*, *supra*, cited by petitioner (Pet. 10), are inapposite. In *Tri-S Corporation*, the court affirmed the Tax Court's determination that a notice of condemnation caused a change in the taxpayer's holding purpose from sale in the ordinary course to investment. *Municipal Bond Corporation* merely stands for the proposition, accepted by the court of appeals here (Pet. App. 14a n.24 & 28a), that it is possible for a taxpayer who is engaged in the business of selling real estate to hold specific property for investment rather than for sale in the ordinary course of its business.